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In the Supreme Court of the United States

OCTOBER TERM, 1935

No. 1

EDWARD B. DOUGLAS, PETITIONER

v.

LEVI M. WILLCUTS, AS COLLECTOR OF INTERNAL REVENUE for the District of Minnesota

---

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

No written opinion was rendered by the District Court. Its findings of fact and conclusions of law appear in the record at pages 56 to 64. The opinion of the Circuit Court of Appeals (R. 82–87) is reported in 73 F. (2d) 130.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered September 13, 1934. (R. 87–88.) A

petition for rehearing was denied October 22, 1934. (R. 88.) Petition for a writ of certiorari was filed November 26, 1934, and was granted April 8, 1935. (R. 89–90.) The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The petitioner in 1923 created a trust by the terms of which the trustee was to pay a specified income for life to the petitioner's wife, about to be divorced from him, in lieu of all alimony and any other rights in his estate, with the provision that if the income should be insufficient to meet the payments as they fell due, the trustee should request the petitioner to make good the deficiency, and if the petitioner should fail to do so, that the deficiency should be made up from the principal of the trust fund, and that in case any securities should become impaired or of doubtful value, the petitioner at the request of the trustee should substitute therefor an equal amount of income-producing securities satisfactory to the trustee. The trust further provided that in event the net income exceeded the required payments, and if the principal was not then impaired, the excess income should be paid to the petitioner, and that upon the wife's death the trust should terminate. The state court in granting the divorce decree specified that the wife should have the provision made in the trust

in lieu of all other alimony or interest in the property or estate of the petitioner.

The question presented is whether the portion of the income from the trust paid to the petitioner's divorced wife in 1927 and 1928 was taxable to the petitioner for those years.

STATUTES AND REGULATIONS INVOLVED

These will be found in the Appendix to this brief, *infra*, pp. 27–31.

STATEMENT

The petitioner brought this suit in the District Court for the District of Minnesota for the recovery of additional income taxes paid for the years 1927 and 1928. (R. 1–7.) Jury trial was waived in writing (R. 56), and the court made findings of fact and conclusions of law (R. 57–64). The facts so found may be summarized as follows:

On September 12, 1923, the petitioner, his wife, Ida M. Douglas, and Minneapolis Trust Company, as trustee, executed an agreement, a copy of which is attached to the petitioner's complaint filed in the District Court. (R. 7–12.) It provided that petitioner thereby assigned to the trustee certain securities listed in an attached schedule of a par or estimated value of $300,000, and that he would further assign and deliver on November 6, 1927, such portion of the properties as he would then receive from the estate of his father under the latter's will as $120,000 bore to the entire property then received by him under the will, the petitioner agree-

ing at said time to transfer to the said trustee securities of the par value of $120,000. (R. 8.) The trustee was to pay to Ida M. Douglas from the principal of the trust estate the sum of $30,000 for the purpose of satisfying certain accrued bills and attorney's fees, and from the income the following amounts in quarterly installments: (a) the sum of $15,000 per annum, beginning as of September 1, 1923, up to and until November 6, 1927; (b) the sum of $21,000 per annum, beginning November 6, 1927, and continuing during her lifetime. (R. 8-9.)

The agreement further provided that in case the net income was not sufficient at any time to make these payments, then the trustee should request such deficiency to be immediately made good by the petitioner, and if the petitioner should fail to do so before the next installment became payable, the trustee should make up the deficiency from the principal of the trust fund; that in case the net income exceeded the required payments, and if the principal was not impaired, the trustee should pay the excess to the petitioner, with the right, however, to reserve from time to time a reasonable amount of income to fairly insure the prompt payment of future installments to Ida M. Douglas; that if the principal should at any time be impaired, and if the petitioner should not make good such impairment, all income in excess of the amount required for annual payments and charges should be added to and become a part of the principal until

the aggregate should reach the principal amount specified; and that in case any securities in the fund should become impaired or of doubtful value, or not likely in the opinion of the trustee to produce a fair proportionate amount of the necessary income, then the petitioner, at the request of the trustee, should substitute therefor an equal amount of income-producing securities satisfactory to the trustee (R. 9–10).

It was expressly agreed that the provisions made for Ida M. Douglas in the agreement were in lieu of and in full settlement of alimony, and of any and all dower rights or statutory interests in the petitioner's estate, and in lieu of any and all claims for separate maintenance and allowance for her support. (R. 10.) It was provided that upon the death of Ida M. Douglas, the trustee should transfer all securities and money held by it to the petitioner, and the trust should then terminate. (R. 12.)

On September 12, 1923, the petitioner conveyed to the trustee the securities described in the schedule attached to the agreement, and on November 6, 1927, certain additional securities pursuant to the agreement. (R. 58, 15, 17.)

On September 15, 1923, the District Court of Beltrami County, Minnesota, entered a decree absolutely divorcing the petitioner and Ida M. Douglas, and further adjudging that the petitioner provide the trust fund as set out in the agreement between the parties on file with the trustee, and

that Ida M. Douglas have the provision therein made "in lieu of all other alimony" or interest in the property or estate of the petitioner. (R. 62–63, 55.)

The net income of the trust for the calendar year 1927 was $12,610.52, and for the calendar year 1928, $17,617.39. (R. 58–59.)[1] These amounts were not included by the petitioner in the gross income on his returns filed for those years. (R. 59–60.) Upon audit of the returns the Commissioner of Internal Revenue included the amounts in income and assessed additional taxes for those years, which, together with interest thereon, were paid by the petitioner under protest. (R. 60–63.) The petitioner duly filed claims for refund, and upon failure of the Commissioner to allow the same this suit was instituted.

The District Court concluded as a matter of law that in the taxable years involved the petitioner did not receive or enjoy the income of the trust or economic benefits of the property transferred (R. 63) and entered judgment in his favor (R. 64). The Circuit Court of Appeals, reversing the District Court, held that the amounts involved were taxable as income to the petitioner because they directly benefited him by discharging a legal obligation he was bound to perform.

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[1] The taxability for 1928 of the income from another trust created by the petitioner on March 16, 1928 (R. 59) is not now involved.

SUMMARY OF ARGUMENT

The income from the trust operated to discharge the petitioner of a legal obligation. It was income to him within the meaning of the Sixteenth Amendment; it was also income to him within the statutory definition of gross income.

The petitioner is therefore accountable for such income unless the existence of the trust provisions of the statute precludes the operation of the gross income provision. The trust provisions, however, are silent as to such trusts, and if they do prevent the operation of the gross income provision, it is by implication only. It would seem clear that they have no such effect for two reasons: First, the courts have construed the trust provisions as non-exclusive; second, to construe the trust provisions as exclusive would furnish the means for circumventing the prior and long-existing statutory prohibition against deductions on account of personal expenses, and thus violate the sound rule of construction that where avoidance is made easy under one interpretation another is to be preferred.

Nor does the decision in *Helvering* v. *Butterworth,* 290 U. S. 365, require a different result. That case held that Congress evidenced an intention not to permit any trust income to escape taxation completely. There the sole question was as between trustee and beneficiary and the continuing obligation of another taxpayer was not involved. This Court held that since the trustee was not taxable under the statute, the beneficiary was subject

to the tax. It did not hold that in every type of trust the income must be taxed only to the fiduciary or the named beneficiary.

ARGUMENT

I

THE INCOME DERIVED FROM THE TRUST SECURITIES DURING THE TAXABLE YEARS WAS USED TO SATISFY THE PETITIONER'S LEGAL OBLIGATION FOR SUPPORT AND MAINTENANCE OF HIS DIVORCED WIFE, AND ACCORDINGLY CONSTITUTED INCOME OF THE PETITIONER TAXABLE AS SUCH

We submit it is plain that the trust was established to provide annual payments for the wife of the petitioner in satisfaction of his legal duty or obligation for her support and maintenance. The instrument provided for fixed payments to the petitioner's wife, which she agreed to accept in lieu of and in full settlement of alimony, and of any statutory interests in his estate, and in lieu of any separate maintenance and allowance for her support. The divorce decree, entered three days thereafter, directed the petitioner to provide the trust fund agreed upon, and that the wife should have the provision therein made in lieu of all other alimony or interest in the petitioner's estate (R. 55). Thus, although the terms were agreed upon before the divorce decree, that decree specifically provided for the payments thereafter made and established a legal obligation of the petitioner to the extent pro-

vided for in the trust. Cf. Mason's Minnesota Statutes, Sections 8601 and 8602, *infra*, p. 27.

The power of the court to make such a decree was not only provided by statute but was also inherent in its equity jurisdiction. *Bensel* v. *Hall*, 177 Minn. 178. This was not a contractual obligation, but was a legal one, founded upon the natural duty of the petitioner to support his wife after the termination of the marriage as well as during its existence, and translated into terms of money by the court decree. *Bensel* v. *Hall, supra; Sessions* v. *Sessions*, 178 Minn. 75. The court may modify or increase the award despite the fact that its original decree was made pursuant to stipulation of the parties. *Warren* v. *Warren*, 116 Minn. 458; *Randall* v. *Randall*, 181 Minn. 18; *Erickson* v. *Erickson*, 181 Minn. 421; *Haskell* v. *Haskell*, 119 Minn. 484. And the court is not controlled by the stipulation, but may adopt or reject it as seems consistent and proper. *Warren* v. *Warren, supra.*

The income paid during the years involved was thus used to meet a personal and legal obligation of the petitioner. Petitioner's liability was not met by the mere creation of the trust itself. As we have noted heretofore, it was subject to change by the court. Moreover, his wife did not have to look solely to the income of the trust for the payments of the specified amounts. If the income should be insufficient to meet the required payments the trustee could call upon the petitioner, and if he failed

to satisfy the deficiency, then it was to be met by application of a part of the corpus (R. 9).

Furthermore, if the principal became impaired, or in the judgment of the trustee was insufficient, the petitioner was bound to substitute other securities satisfactory to the trustee (R. 10). Thus, we submit, there was a continuing obligation upon the petitioner, adjudged by the court, to furnish sufficient funds to meet the specified annual payments, and the court below correctly determined that, to the extent that the income from the trust was actually paid to the divorced wife, it operated only *pro tanto* to discharge a continuing personal obligation of the creator.

Petitioner argues (Br. 14–15) that there was in substance merely an approval by the divorce court of an earlier division of property between the parties. This we contend is not an accurate description of the court's action. Under the statute (Mason's Minnesota Statutes (1927), Sec. 8602, *infra,* p. 27), the court may order to the wife for her support such part of the personal and real estate of the husband and such alimony out of his estate, earnings and income as it may deem just and reasonable, not exceeding in present value one-third of his personal estate, earnings and income, and one-third in value of his real estate. Apparently proceeding under the authority of this section the court awarded to the petitioner's wife the amount agreed upon, consisting of a yearly sum to continue during her life and ceasing upon

her death. The sum payable during each of the years involved was less than one-third of the petitioner's total net income, including the income from the trust. (R. 58–59, 60.)

This constituted, we contend, an annual income provided for the wife's support, and in no true sense a division of property. She received no title to the corpus of the trust, and the title held by the trustee was to revest in the petitioner or his heirs or assigns upon her death. No property was divided between the parties, the sole effect being to establish a present fund from which the payments were to be made in the first instance. Whatever its characterization, it represented a legal obligation of the petitioner for his wife's support, decreed by the court and subject to change, and met thereafter by payments from the income of the trust.[2]

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[2] In any event, the petitioner is precluded at this stage of the proceedings from contending that the income was not used to satisfy a legal obligation. The petition for certiorari in this case was originally denied and the subsequent granting thereof would seem to have been based solely upon the asserted conflict between this case and *Schweitzer* v. *Commissioner*, 75 F. (2d) 702 (C. C. A. 7th), decided subsequent to the original denial of certiorari here. The income in the *Schweitzer* case was used to discharge a legal obligation of the grantor and the alleged conflict between the two cases must necessarily presuppose the existence of a similar obligation here which was likewise discharged by the income from the trust. We believe, therefore, that it should be assumed, for the purpose of litigation in this Court, that the court below correctly disposed of this subsidiary issue. Cf. *United States* v. *Henry Prentiss & Co.*, 288 U. S. 73, 88; *Steele* v. *Drummond*, 275 U. S. 199, 203.

We submit, accordingly, that the income in question was so obviously devoted and used for the petitioner's own benefit as to constitute it his income taxable as such.

The principle, that the payment of one's obligations by another by the former's direction constitutes income to the person whose obligation is discharged, is exemplified by the decisions of this Court in *Old Colony Tr. Co.* v. *Commissioner*, 279 U. S. 716, and *United States* v. *Boston & M. R. Co.*, 279 U. S. 732. In the former case the amount of an employee's income taxes paid by his employer was held to be taxable income to the employee, and in the latter case it was held that a lessor received income where his income taxes were paid by the lessee. This principle was further extended in *United States* v. *Mahoning Coal R. R. Co.*, 51 F. (2d) 208 (C. C. A. 6th), certiorari denied, 285 U. S. 559, to a payment of income taxes of a lessor by a lessee, even though the lessee was under no obligation to pay the taxes. Again, it has been decided that an employee realized income where an employer paid premiums on a policy of insurance on the life of the employee even though the employee's wife was the beneficiary. *Yuengling* v. *Commissioner*, 69 F. (2d) 971 (C. C. A. 3d); *Adams* v. *Commissioner*, 18 B. T. A. 381; *Danforth* v. *Commissioner*, 18 B. T. A. 1221. Cf. *Lansill* v. *Burnet*, 58 F. (2d) 512 (App. D. C.)

We submit there is no real difference in principle between those situations and the case here. The

payments made to satisfy the petitioner's legal obligation were equivalent to receipt by him just as much as the payments of the taxpayers' income taxes were constructively received in the cases cited above. In each instance there was a substantial and real benefit to the taxpayer by reason of the satisfaction of his obligation. If the petitioner here had directed his bank to pay over income as it accrued from deposits for the support of his wife, we believe there can be no doubt that the income so accruing and paid would constitute taxable income to him in the first instance. The fact that he accomplished the same purpose and met his obligation by payments from a fund placed in trust should make no real difference in the incidence of the tax. The trust was simply a means by which he met his legal obligation to his wife, and the trustee was in reality acting as his agent for this purpose.

The gross income provisions of Section 213 of the Revenue Act of 1926 (*infra*, p. 28), and Section 22 (a) of the Revenue Act of 1928 (*infra*, p. 31) are broad and all-inclusive. They tax income from whatever source derived. This Court has stated that Congress intended to use its power to the full extent. *Irwin* v. *Gavit*, 268 U. S. 161, 166; *Helvering* v. *Stockholms &c. Bank*, 293 U. S. 84, 89. We submit that under these provisions the income for the years 1927 and 1928 was taxable to the petitioner. There can be no doubt that this constituted income which might constitutionally be taxed to

the petitioner. This is illustrated by the decision of this Court in *Burnet* v. *Wells*, 289 U. S. 670, holding that under the statute income from an irrevocable trust devoted by direction of the grantor to pay premiums on his life insurance policies was taxable as his income. While the statute under consideration there specifically laid a tax upon the grantor of the trust, and the sole question involved the constitutionality of the provision, the necessity of a specific legislative direction may well be doubted in view of the broad gross income provisions of the Revenue Acts. So, in *Corliss* v. *Bowers*, 281 U. S. 376, this Court upheld the validity of a legislative provision specifically taxing income to a grantor of a trust who retained the power to revoke. Yet in certain cases involving similar circumstances, but under Revenue Acts containing no such specific provision, the courts have held that the income was taxable to the grantor. Cf. *McCauley* v. *Commissioner*, 44 F. (2d) 919 (C. C. A. 5th); *Dickey* v. *Burnet*, 56 F. (2d) 917 (C. C. A. 8th), certiorari denied, 287 U. S. 606; *O'Donnell* v. *Commissioner*, 64 F. (2d) 634 (C. C. A. 9th), certiorari denied, 290 U. S. 699.

In the *McCauley* case the court, discussing the decision in *Corliss* v. *Bowers*, *supra*, said (p. 920):

> It is true that decision is under the Revenue Act of 1924 §§ 219 (g), (h), 26 U. S. C. A. § 960 note, which provided in terms that the grantor of a trust who reserved the power to revest in himself title to any part

> of the corpus of the trust should be liable for the tax. But that Revenue Act, as it appears to us from its history, was merely declaratory of existing law, and the language quoted is therefore applicable to the facts of this case.

In the *Wells* case, *supra*, this Court, in holding that the income from a trust used to pay insurance premiums might be taxed as income to the grantor, also indicated that such taxation was desirable in order to prevent avoidance of taxes by taxpayers who had contrived to keep the larger benefits of ownership and be relieved of the attendant burdens. In this respect this Court said in part (p. 677):

> Through the devices thus neutralized as well as through many others there runs a common thread of purpose. The solidarity of the family is to make it possible for the taxpayer to surrender title to another and to keep dominion for himself, or if not technical dominion, at least the substance of enjoyment. At times escape has been blocked by the resources of the judicial process without the aid of legislation. * * *. In these and other cases there has been a progressive endeavor by the Congress and the courts to bring about a correspondence between the legal concept of ownership and the economic realities of enjoyment or fruition. Of a piece with that endeavor is the statute now assailed.

We contend that the present situation is one where such avoidance may and should be prevented

if necessary by judicial process, which can be accomplished without doing violence to the law. There is no need for a specific legislative declaration in view of the broad scope of the gross income provisions of the statute. This is a stronger case than the *Wells* case, *supra*, in which to hold that income is attributable and taxable to the grantor. There the income was not used to satisfy a strict legal obligation but was devoted to keeping alive contracts of insurance which the taxpayer was not forced to continue. The dissenting opinion in the *Wells* case recognizes that income devoted to payments which the settlor is bound to make has (p. 684) "the substantial elements of income to the settlor." Clearly, in the present case, since the income was devoted pursuant to court decree to meet the obligation of the petitioner to provide an annual income for his wife, it had the substantial elements of income to the petitioner.[3] Therefore, even if the grantor in the *Wells* case would not have been taxable in the absence of a specific legislative declaration, we submit that the income herein is economically more closely income to the grantor than in the *Wells* case, and hence may be included in the gross income provision of the statute.

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[3] The members of the Court who dissented in the *Wells* case concurred in the companion case of *DuPont* v. *Commissioner*, 289 U. S. 685, on the ground that the grantor in the latter case did not divest himself permanently of title to the trust property. It is worthy of note that the grantor herein similarly reserved to himself the corpus, to be turned over to him at the termination of the trust.

Authority on the point involved is conflicting. The present administrative rulings provide that the settlor shall be taxed upon income from an irrevocable trust created to provide payments in lieu of alimony. I. T. 2628, XI–1 Cumulative Bulletin 34; G. C. M. 13308, XIII–2 Cumulative Bulletin 184. This represented the earlier view of the Bureau (O. D. 399, 2 Cumulative Bulletin 156), which had been overruled (O. D. 1092, 5 Cumulative Bulletin 190). The Board of Tax Appeals has held that income derived from trusts created to meet alimony payments is not taxable to the creator. *Lynch* v. *Commissioner*, 23 B. T. A. 435, petition for review dismissed without opinion, by the Circuit Court of Appeals for the Fifth Circuit on February 2, 1932; *Brooks* v. *Commissioner*, 31 B. T. A. 70; *Hyde* v. *Commissioner*, 31 B. T. A. 256; *Tuttle* v. *Commissioner*, 31 B. T. A. 782. But cf. *Spencer* v. *Commissioner*, 20 B. T. A. 58. In those cases, however, the trusts were created merely by agreement, pursuant to no direction by the court decreeing the divorce, and the Board has expressly distinguished this case on that ground. *Tuttle* v. *Commissioner*, *supra*. Accordingly, the attitude of the Board in a case where the obligation is adjudged by the court is a matter of conjecture.[4] In *Coxey* v. *Commis-*

[4] The Board's treatment of the similar class of cases involving trusts for maintenance and support of minor children has not been entirely consistent. In *Schweitzer* v. *Commissioner*, 30 B. T. A. 155, the grantor was held accountable. But he was held not liable in *Stokes* v. *Com-*

sioner, decided September 25, 1935, not yet officially reported, the Circuit Court of Appeals for the Third Circuit, one judge dissenting, affirmed the Board's decision, refusing to tax the husband where the assignment of trust income was made some time before divorce and the decree made no provision for alimony.

Certain other decisions of the Board and of the courts are, we contend, authority for taxation of the petitioner in the instant case, even without specific declaration in the divorce decree. Those are cases in which it has been held that alimony payments made from a fund transferred or dedicated as collateral security for such payments were taxable as income to the husband. *Welch* v. *Commissioner,* 12 B. T. A. 800; *Turner* v. *Commissioner,* 28 B. T. A. 91, affirmed, *per curiam* (on the authority of *Gould* v. *Gould,* 245 U. S. 151) by the Circuit Court of Appeals for the Second Circuit, 71 F. (2d) 1018; *Longyear* v. *Commissioner,* 28 B. T. A. 1086, affirmed, 77 F. (2d) 116 (App. D. C.). The provisions of the agreement demonstrate that substantially the same situation exists here. The petitioner's wife was to receive, not the entire income which might result from the securities trans-

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missioner, 28 B. T. A. 1243, affirmed July 31, 1935, not yet officially reported but may be found in C. C. H. (1935), Vol. 3-A, p. 10307 (C. C. A. 3d); *Yeiser* v. *Commissioner,* unpublished decision, affirmed, 75 F. (2d) 956 (C. C. A. 6th); *Grosvenor* v. *Commissioner,* 31 B. T. A. 574; *Savage* v. *Commissioner,* 31 B. T. A. 633; *Clark* v. *Commissioner,* 31 B. T. A. 1082.

ferred to the trustee, but a specified yearly amount, and the trustee held the fund only for the period during which the payments were required to be made. The petitioner could be called upon to supply any deficiency in the income, and in default it might be made good from the principal. Furthermore, the petitioner was required to make good any impairment of the principal. In essence the fund placed in trust was no more than security to insure the payment of amounts due from the petitioner for the support of his wife.

The fact that legal title to the principal rested temporarily in another should not prevent taxation of the payments as petitioner's income any more than did a similar situation in the *Turner* and *Longyear* cases, *supra*. As stated by this Court in *Corliss* v. *Bowers*, 281 U. S. 376, 378, and repeated in *Burnet* v. *Wells*, 289 U. S. 670, 678, "taxation is not so much concerned with the refinements of title as it is with actual command over the property taxed—the actual benefit for which the tax is paid." The petitioner here did not divest himself of all interest in the fund which produced the income. It reverted to him or his heirs upon his wife's death, when the obligation to support ceased. Prior to that time he had the right to recover the securities by substitution and thus dispose of them, subject only to the approval of the trustee. (R. 9). Meanwhile, the income was devoted to the payment of his obligation, and he was in a real sense the beneficiary of the trust. We submit that

the amounts so paid during the taxable years were income to the petitioner within the purview of the gross income provisions of the statutes, *infra*, and were properly taxable to him as such.[5]

II

THE TRUST PROVISIONS OF THE STATUTES INVOLVED DO NOT PRECLUDE THE TAXATION OF THIS INCOME TO THE PETITIONER

We believe it is plain, as above indicated, that the income herein should be considered as falling within the general definition of gross income, taxable to the grantor. But the petitioner contends that the trust provisions (Section 219, Revenue Act of 1926, *infra*, p. 29; Section 162 (b), Revenue Act of 1928, *infra*, p. 31) furnish an exclusive method

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[5] The situation herein is also not unlike that in those cases in which an assignor of income has been held taxable although the assignment was irrevocable. The court, in *Commissioner* v. *Plant*, 76 F. (2d) 8 (C. C. A. 2d), commented on that similarity, saying (p. 10):

> The recent decision of the Court of Appeals of the Eighth Circuit in *Willcuts* v. *Douglas*, 73 F. (2d) 130, is also relied on by the Commissioner. There a trust was set up by a husband containing a provision for his wife in lieu of alimony as required by a decree of divorce. The income, though payable to her, was held taxable against the settlor. But in that case the income was derived from property originally belonging to the settlor, and was devoted to the discharge of the latter's legal obligations. The transaction resembled an assignment by a husband to his wife of his future salary or of his interest in future profits of his firm. *Lucas* v. *Earl*, 281 U. S. 111, 50 S. Ct. 241, 74 L. Ed. 731; *Burnet* v. *Leininger*, 285 U. S. 136, 52 S. Ct. 345, 76 L. Ed. 665.

for taxing trust income, and that since the grantor would not be accountable for that income under the trust provisions, he may not be taxed under any other section of the Acts. And in this connection he relies upon the decision of this Court in *Helvering* v. *Butterworth*, 290 U. S. 365:

But the trust provisions have not been regarded as furnishing an exclusive mode of taxing such income. For example, it was not until the Revenue Act of 1924[6] that the grantor of a revocable trust was made specifically accountable as to the income therefrom. Prior to that time, however, there was a comprehensive system of taxing trust income as between the trustee and the beneficiary. Yet the courts held in cases arising under such prior Revenue Acts that income from a revocable trust was taxable to the grantor. *McCauley* v. *Commissioner*, 44 F. (2d) 919 (C. C. A. 5th); *Dickey* v. *Burnet*, 56 F. (2d) 917 (C. C. A. 8th), certiorari denied, 287 U. S. 606; *O'Donnell* v. *Commissioner*, 64 F. (2d) 634 (C. C. A. 9th), certiorari denied, 290 U. S. 699.

Moreover, whatever reasons may exist for construing the trust provisions as exclusive are counteracted in this case by the express statutory prohibition against deductions for personal and family expenses.[7] This prohibition clearly has the

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[6] Section 219 (g) and (h), Revenue Act of 1924, c. 234, 43 Stat. 253 (U. S. C., Title 26, Sec. 960). See *Corliss* v. *Bowers*, 281 U. S. 376.

[7] Section 215 (a) (1) of the 1926 Act and Section 24 (a) (1) of the 1928 Act, *infra*, pp. 29, 31.

effect of denying deductions for payments of alimony. Such payments are not business expenses, which are the only deductions allowable to an individual under the Revenue Acts, and the regulations have uniformly denied their deduction (Regulations 69, Article 291, *infra*, p. 31; Regulations 74, Article 281. See also Regulations 45, Article 291; Regulations 62, Article 291; Regulations 65, Article 291; Regulations 77, Article 281; Regulations 86, Article 24–1). This Court has stated that they do not decrease the taxable income of the husband. *Gould* v. *Gould*, 245 U. S. 151. And see *Longyear* v. *Helvering, supra; Joyce* v. *Commissioner*, 3 B. T. A. 393; *Van Den Bosch* v. *Commissioner*, 26 B. T. A. 679, 682. Certainly the petitioner would have been precluded from deducting amounts paid to his wife as alimony had he paid them directly rather than by way of the trust. We contend that he should not be allowed such a deduction merely because he arranged for the payments to be made indirectly.

The device for which the petitioner seeks judicial sanction is alarming in its potentialities. If the petitioner is correct, anyone with income-producing property could render meaningless the prohibition against deductions for personal expenditures by creating a blanket trust (or series of trusts) to meet specified obligations, such as rent and other personal expenses, retaining to himself the excess income as well as the right to the corpus at the ter-

mination of the trust.[8] But this Court has held that where tax avoidance is made easy under one interpretation of the statute another interpretation is to be preferred. *Carbon Steel Co.* v. *Lewellyn*, 251 U. S. 501.

The income in question is definitely income to the grantor, we submit, within both the meaning of the Sixteenth Amendment and the statutory definition of gross income. It must therefore be taxed to him unless the trust provisions of the statute operate to exclude that income from the general category of gross income. That those provisions do not have that effect is evidenced, first, by the fact that courts have construed them as non-exclusive, and second, by the principle that such construction would be contrary to the policy of the Act to deny deductions on account of personal expenses, and would thus conflict with the sound canon of construction not to interpret a statute in such manner as to render avoidance a simple matter.

Helvering v. *Butterworth, supra* does not, we contend, stand for the proposition that income derived from securities placed in trust is taxable only to the fiduciary or the named beneficiary and no one else. There may be situations in which it is taxable to the creator as well as to the named beneficiary. Or, again, it may happen that the creator only should be taxable, and not the beneficiary. For example: Let it be assumed that the trust is

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[8] Cf. *DuPont* v. *Commissioner*, 289 U. S. 685.

formed for him by the beneficiary. It would seem clear that the beneficiary is taxable, since he is essentially receiving wages or salary. Such result would be entirely consistent with taxing the grantor also, since payments out of income from property placed in trust by him operate to relieve him of a legal obligation and confer upon him exactly the same economic benefit as though he had directly received the income from the property and paid it over to his creditors. In the latter situation there can be no doubt but that both debtor and creditor would be taxable.

Again, let it be assumed that the trust is created to repay borrowed money to the beneficiary. In such case the beneficiary would probably not be taxable, since he is receiving merely a return of capital.* Or, consider the beneficiary in the instant case. Since the payments under the trust are in lieu of alimony, it may be that the beneficiary is not taxable under this Court's decision in *Gould* v. *Gould*, 245 U. S. 151. And see *Spencer* v. *Commissioner*, 20 B. T. A. 58. In any event, since she could look to the corpus of the trust if the income were insufficient to meet the specified annual pay-

* Compare, for example, *Blumenthal* v. *Commissioner*, 76 F. (2d) 507 (C. C. A. 2d), certiorari applied for, *Helvering* v. *Blumenthal*, No. 82, October Term, 1935. There the trust was for the repayment of a $75,000 loan bearing 5½% interest. It would seem that the creditor would not be taxable to the extent that he receives a return of principal, but would be taxable to the extent of the interest.

created by the grantor to pay for services perments, she would appear to be exempt. *Burnet* v. *Whitehouse*, 283 U. S. 148; *Helvering* v. *Pardee*, 290 U. S. 365, 370–371 (reported in the same opinion as *Helvering* v. *Butterworth, supra*).

Another situation is presented by the trusts created for the maintenance and support of the grantor's minor children.[10] The contention is there made that the children are taxable since they are "beneficiaries" within the meaning of *Helvering* v. *Butterworth, supra*, and, therefore, that Congress did not intend to tax both grantor and beneficiary in that kind of case. But that line of argument loses the true import of the *Butterworth* decision. There, failure to tax the beneficiary would have resulted in the trust income going entirely untaxed. The trust under consideration in that case was testamentary, and the only question before the Court was the tax liability as between the beneciary and the trustee, which is not true here. The trustee was held not taxable under the statute. In holding the beneficiary liable, this Court declared that Congress did not intend to allow income from a trust to escape taxation completely. It may well

[10] See *Schweitzer* v. *Commissioner*, 75 F. (2d) 702 (C. C. A. 7th), certiorari applied for, *Helvering* v. *Schweitzer*, Nos. 69 and 70, October Term, 1935. It is assumed, of course, that the funds are employed to discharge the grantor of a legal obligation to support his children. If the income is in excess of his legal obligation, the present issue is raised only to the extent that the income is within such obligation.

be, therefore, that if the grantor in this case is held taxable, the reason for applying the *Butterworth* decision will fail, and the beneficiary may be thus exempt. In any event, if the same item is actually income (as distinguished from a mere return of capital, etc.) to a beneficiary, there would appear to be nothing inconsistent with taxing him in respect thereto, and at the same time taxing the grantor for something entirely different, namely, the discharge of his legal obligation.

We submit that the *Butterworth* decision does not compel income from a trust in every case to be taxable either to the fiduciary or to the beneficiary to the exclusion of any other person, and that the grantor is properly taxable where the income is applied for his benefit.

CONCLUSION

The court below properly held that the income of the trust for the taxable years involved was used to satisfy a legal obligation of the petitioner and was accordingly taxable as income to him. Its decision should be affirmed.

Respectfully submitted.

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APPENDIX

Mason's Minnesota Statutes (1927), Vol. 2:

SEC. 8601. *Trustee of alimony.*—The court may appoint trustees, whenever it is deemed expedient, to receive any money ordered to be paid to the wife, upon trust to invest the same, and pay over the income for the support of the wife, or of the wife and minor children of the parties, or any of them, in such manner as the court shall direct, or to pay over to the wife the principal sum in such proportions and at such times as the court shall order, regard being had in all such cases to the situation and circumstances of such wife, and the children if there are any, provided for in the order; and such trustees shall give such bond, as the court shall require, for the faithful performance of their trust.

SEC. 8602. *Property of husband—Permanent alimony.*—Upon a divorce for any cause except that of adultery committed by the wife, if the estate and property restored or awarded to her is insufficient for the suitable support of herself and such children of the marriage as shall be committed to her care and custody, or if there is no such estate and property, the court may further order and decree to her such part of the personal and real estate of the husband, not exceeding in value one-third thereof, as it deems just and reasonable, having regard to the ability of the husband, the

character and situation of the parties, and all other circumstances of the case. The court may also, in the cases provided for in this section, decree to the wife such alimony out of the estate, earnings, and income of the husband as it may deem just and reasonable, having regard to the ability of the husband, the character and situation of the parties and other circumstances of the case, and may by its decree make the same a specific lien upon any specified parcels of his real estate, or authorize its enforcement by execution against his property, real and personal; but the aggregate award and allowance made to the wife from the estate of the husband under this section shall not in any case exceed in present value one-third of the personal estate, earnings, and income of the husband, and one-third in value of his real estate.

SEC. 8603. *Order for alimony, etc., revised.*—After an order or decree for alimony, or other allowance for the wife and children, or either of them, or for the appointment of trustees to receive and hold any property for the use of the wife or children, the court, from time to time, on petition of either of the parties, may revise and alter such order or decree respecting the amount of such alimony or allowance, and the payment thereof, and also respecting the appropriation and payment of the principal and income of the property so held in trust, and may make any order respecting any of the said matters which it might have made in the original action.

Revenue Act of 1926, c. 27, 44 Stat. 9, 23, 28, 32:

SEC. 213. * * *

(a) The term "gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal

service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *.

(U. S. C. App., Title 26, Sec. 954.)

SEC. 215. (a) In computing net income no deduction shall in any case be allowed in respect of—

(1) Personal, living, or family expenses;

* * * * *

(U. S. C. App., Title 26, Sec. 956.)

SEC. 219. (a) The tax imposed by Parts I and II of this title shall apply to the income of estates or of any kind of property held in trust, including—

* * * * *

(2) Income which is to be distributed currently by the fiduciary to the beneficiaries, and income collected by a guardian of an infant which is to be held or distributed as the court may direct;

* * * * *

(b) Except as otherwise provided in subdivisions (g) and (h), the tax shall be computed upon the net income of the estate or trust, and shall be paid by the fiduciary. The net income of the estate or trust shall be computed in the same manner and on the same basis as provided in section 212, except that—

* * * * *

(2) There shall be allowed as an additional deduction in computing the net income

of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries, and the amount of the income collected by a guardian of an infant which is to be held or distributed as the court may direct, but the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries whether distributed to them or not. Any amount allowed as a deduction under this paragraph shall not be allowed as a deduction under paragraph (3) in the same or any succeeding taxable year;

(3) In the case of income received by estates of deceased persons during the period of administration or settlement of the estate, and in the case of income which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated, there shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is properly paid or credited during such year to any legatee, heir, or beneficiary, but the amount so allowed as a deduction shall be included in computing the net income of the legatee, heir, or beneficiary.

* * * * *

(g) Where the grantor of a trust has, at any time during the taxable year, either alone or in conjunction with any person not a beneficiary of the trust, the power to revest in himself title to any part of the corpus of the trust, then the income of such part of the trust for such taxable year shall be included in computing the net income of the grantor.

> (h) Where any part of the income of a trust may, in the discretion of the grantor of the trust, either alone or in conjunction with any person not a beneficiary of the trust, be distributed to the grantor or be held or accumulated for future distribution to him * * * such part of the income of the trust shall be included in computing the net income of the grantor.
>
> (U. S. C. App., Title 26, Sec. 960.)

To the extent that they are material, the corresponding sections (22 (a), 24 (a), 162 (b), 166, and 167) of the Revenue Act of 1928, c. 852, 45 Stat. 791, 797, 802, 838, 840, are substantially identical with the above.

Treasury Regulations 69, issued under the Revenue Act of 1926:

> ART. 291. *Personal and family expenses.*— * * *. Alimony and an allowance paid under a separation agreement are not deductible from gross income. * * *.

This statement is also contained in Article 281 of Treasury Regulations 74, issued under the Revenue Act of 1928.

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